
CHAPTER 6. PROJECTS WITH REPAIRS

6-1. CRITICAL AND NONCRITICAL REPAIRS. Critical repairs must be completed, inspected and approved by the Field Office before endorsement. However, noncritical repairs may be deferred until after endorsement in accordance with the procedures in this chapter. Noncritical repairs are those that will not:

- endanger the safety and well-being of tenants, visitors and passersby,
- adversely affect ingress or egress, or
- prevent the project from reaching sustaining occupancy.

6-2. REPAIR ESCROW. When repairs are proposed that will be completed using mortgage proceeds after endorsement, a repair escrow must be established similar to that used in the Section 223(f) program. Repairs must begin immediately after endorsement and be completed within 12 months.

6-3. ESCROW AGREEMENT (Form FHA-2476-A).

A. The mortgagor must establish an escrow with the mortgagee equal to at least 150 percent of the estimated cost of the repairs to completed after endorsement. The escrow shall be funded as follows:

1. Costs of the deferred repairs (including materials, labor, permits, profits, etc., trended to the start of repairs) must be estimated and withheld in cash from mortgage proceeds and placed in escrow. A letter of credit may not be substituted for this 100 percent escrow.
2. An additional cash amount (or letter of credit, at option of the mortgagee) of not less than 50 percent of the repair cost estimate will also be placed in escrow.

(6-3) B. The mortgagee may release funds from the escrow as work is completed, releasing funds first from the mortgage proceeds portion of the escrow.

- C. Funds remaining in the escrow account, including the 50 percent portion provided by cash or letter of credit, may be released when: (1) all repairs have been satisfactorily completed, (2) a supplemental cost certification (see paragraph 6-5) has been approved by the Field Office; and (3) latent defects assurances have been provided (if required; see paragraph D. below).

The supplemental cost certification must indicate that there are no further amounts owed by the mortgagor in connection with the repairs. The updated title search must indicate that no liens have been placed on the project as a result of the repairs.

- D. Latent defects assurances are not required where the repairs relate only to deferred maintenance items and minor cosmetic repairs such as painting. When repairs and replacements are more significant, see latent defects requirements in paragraph 6-4C below.

6-4. COMPLETION OF DEFERRED REPAIRS.

- A. All deferred repairs must be completed by the mortgagor within 12 months of endorsement (or such shorter period as HUD and the mortgagee may specify).
- B. If the mortgagor has not completed all repairs by the end of the repair period (including any extensions approved by the Director of the Housing Development Division), the mortgagee will complete the repairs using the escrowed funds. The mortgagee will provide the mortgagor with a breakdown of these repairs and the cost(s) of completion (including administrative expenses). The mortgagor will use this breakdown in preparing the supplemental cost certification required by paragraph 6-5 below. Funds remaining in the escrow account after completion and after the supplemental cost certification has been approved by the Field Office will be returned to the mortgagor less reasonable administrative costs incurred in completing the repairs.

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- (6-4) C. When required, assurance against latent defects for 1 year from completion of repairs must be provided by one of the following:

1. An escrow in cash, or letter of credit at the option of the mortgagee, equal to 2-1/2 percent (or greater percentage as warranted) of the repair cost maintained for 15 months from completion of repairs to cover situations where the defect is discovered in the twelfth month and additional time is necessary to correct it.
2. A Surety Bond covered by Form FHA-3259 from a surety on the accredited list of the U. S. Treasury for at least 10 percent of the repair cost. (The Bond runs for a period of 2 years from the date of completion of repairs.)

6-5. REQUIREMENTS AFTER COMPLETION OF DEFERRED REPAIRS.

- A. The mortgagor must submit a supplemental cost certification of the actual costs of the deferred repairs.
- B. In cases where actual costs are less than estimated, the maximum insurable loan amount must be recalculated. If the maximum insurable mortgage is reduced due to lower actual costs, the mortgagor must prepay the mortgage in one of two ways:
 1. Remit the required prepayment, or
 2. Have the required prepayment amount deducted from the balance of the repair escrow.

6-6. INSPECTIONS. Inspections for repair cases may be performed by HUD Architectural and Engineering staff or under contract. Although the Technical Disciplines Contracts do not specifically reference Section 223(a)(7), the Statement of Work has procedures for "special inspections," including Section 223(f) and guarantee inspections. The procedures are based on a single fixed price per inspection for all such inspections. Section 223(a)(7) repair inspections are identical to those done under Section 223(f) projects or for guarantee inspections.

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- (6-6) A. If repairs will be completed before endorsement, use the instructions in Chapter 3 of Handbook 4565.1 for inspections under the Section 223(f) program.
 - B. When the Field Office has permitted the project owner to defer noncritical repairs until after endorsement,

the owner will notify the Architectural, Engineering, and Cost (A&E) Branch Chief when repairs are underway in accordance with Firm Commitment requirements. While Section 223(a)(7) are likely to require only a final inspection of the work, interim inspections may be made where A&E finds such inspections warranted.

- 6-7. COST CERTIFICATION. Since the level of repairs is expected to be limited, use the simplified cost certification procedures for Section 223(f) in Handbook 4565.1 when the transaction includes repair work.